No. 7322.

In the

United States
Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Leo A. Madden, Ancillary Receiver of Piggly Wiggly Yuma Company, a corporation,

Appellant,

vs.

Morris LaCofske,

Appellee.

BRIEF OF APPELLEE.

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STATEMENT OF THE CASE.

Since the facts set forth in the petition of Leah Goldsmith, attorney-in-fact for Morris LaCofske, appellee herein [T. R. pp. 8-27], has been stipulated to as being true and correct, [T. R. pp. 27-28] it is not necessary to set forth herein appellee's version of the facts, but they will only be referred to hereinafter by way of illustration when the occasion demands.

The importance of the question of the nature and extent of a receiver's liability upon a lease or other contract of the insolvent which he has affirmed or adopted, which question is presented in the instant case, is respectfully called to the attention of this Court. The problem is a vital one, and is made particularly so under present distressing economic conditions which necessitate the operation of many enterprises under equitable receiverships. Not only are the rights of the litigants herein involved, but also the rights of that large body of people, comprising creditors of insolvent enterprises, those who claim some interest in the property taken over, and those who succeed to the assets of the insolvent estate, either by purchase or otherwise. Counsel for appellant herein advances a theory which if approved by the Court would put it within the power of a receiver to disregard the legal rights of some parties concerned, without any right of redress on their part. If a receiver is legally permitted to disclaim all responsibility for his acts (a necessary consequence of the theory advanced by counsel for appellant herein), it is submitted that the door would be thrown wide open for the possibility of "receivership rackets" such as have not as yet been experienced. It is for this reason that counsel for appellee presents the situation here and the law applicable thereto at such length.

PROPOSITIONS OF LAW.

The appellee submits the following propositions of law which he believes are applicable to the instant case.

I.

An equitable receiver who adopts or affirms the lease of his insolvent, is liable to the lessor thereon for the entire term, and upon each and every covenant contained therein.

(a) A receiver does not by adopting or affirming a lease become an assignee of the lessee thereunder by operation of law.

(1) He does not take title to the property, and he is not an assignee of the term.

(2) There is no privity of estate between him and the lessor, and he is not liable upon the covenants by reason of such privity.

(b) A receiver is substituted, in effect, for the original lessee upon his adoption or affirmance of a lease contract.

(1) This is apparent from the language of the decisions.

(2) It is apparent from the fact that the decisions have held a receiver liable for breaches occurring under the lease PRIOR to his adoption thereof.

(3) It is apparent from the fact that the decisions have held that the receiver adopts the lease *in toto,* with all of its terms, conditions and covenants, and for the entire term.

(4) It is apparent from the application of equitable principles and considerations.

II.

One having a landlord's lien upon the personal property of the lessee on the demised premises, is entitled to assert his lien against the funds of his insolvent lessee in *custodia legis.*

(a) He has a statutory right.

(b) He has an equitable right.

I.

An Equitable Receiver Who Adopts or Affirms the Lease of His Insolvent Is Liable to the Lessor Thereon for the Entire Term, and Upon Each and Every Covenant Contained Therein.

(a) A Receiver Does Not by Adopting a Lease Become an Assignee of the Lessee Thereunder by Operation of Law.

It is true that numerous statements may be found in the language of the courts to the effect that a receiver is the assignee of the lease, ("Adoption and Rejection of Contracts and Leases by Receivers", 46 Harvard Law Review, pp. 1111-1136, by Ellsworth E. Clark, Henry E. Foley and Oscar M. Shaw, of the New York Bar; 1 Tiffany, Landlord & Tenant, p. 984). That this statement is correct only if limited to cases where the title to the property of the insolvent is vested in the receiver, either by statute, the order of appointment, act of the parties, or some other means, is recognized in numerous cases.

The question of a chancery receiver's liability on a lease which he has affirmed was fully discussed in the case of *Quincy, etc., Ry. Co. v. Humphreys,* 145 U. S.

82-101, 12 Sup. Ct. 787, 792, 36 L. Ed. 632. The distinction which is taken in the case at bar was argued on behalf of the trust company in *U. S. Trust Company v. Wabash Ry. Co.,* 150 U. S. 287, 14 Sup. Ct. 86. His liability rests, not on an equitable assignment to the receiver of the unexpired term, but *on the fact of the adoption of an existing contract.* (See cases cited in *U. S. Trust Co. v. Wabash, supra;* Clark on Receivers, p. 602, Sec. 443.)

That the receiver is not an assignee of the term, as contended for by counsel for appellant herein, seems to be settled. The Court said, in discussing this question in *Dayton Hydraulic Co. v. Felsenthall,* 116 Fed. 961, at page 964:

> "In the absence of any statute casting the title upon the receiver, or some assignment made by the lessee, it is difficult to see how a judicial receiver can in any accurate sense be said to be the assignee of the term. There is no privity of estate between such a receiver and the lessor, as the appointment neither changed the title or created any lien on the property. These principles are well settled (citing cases) * * * *That a chancery receiver is not an assignee of a term is thoroughly settled in New York.** *Stokes v. Hoffman House,* 174 N. Y. 554, 60 N. E. 667, where the New York cases are reviewed."

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* Unless otherwise indicated, all italics are ours.

Again, in *Bell v. American Protective League,* 163 Mass. 558, 40 N. E. 875, 47 Am. St. Rep. 481, 28 L. R. A. 542, the Court pointed out that a receiver is not, in the absence of statute, an assignee of the term:

> "It is a familiar doctrine of the common law that, while there is no privity of contract between the lessor and the assignee of a term, there is a privity of estate, which renders the assignee liable upon the covenants of the lease, so long as he holds the term. This applies not only to private individuals, but to assignees in bankruptcy and insolvency, as the title to the leasehold estate vests in them, provided they take possession. But an assignee of a term or an assignee in bankruptcy may, by assigning the term, free himself from all further responsibility; and this assignment may be made to any one, however irresponsible he may be, provided the assignor does not retain any interest in the thing assigned. See 2 Platt, Leases, 400-452.
>
> "*It is difficult to see upon what principle a receiver,* in the absence of a statute vesting the title to the insolvent in him, *can, in any legal sense, be said to be the assignee of a term.* In *Ellis v. Boston, H. & E. R. Co.,* 107 Mass. 1, 28, it was said by Mr. Justice Wells, speaking of a decree of this court appointing receivers of a railroad company: 'It had no effect to change the title or create any lien upon the property. Its purpose, like that of an injunction *pendente lite* was merely to preserve the property until the rights of all parties could be adjudged. The receivers are officers of the court for this purpose, and act under its direction and control'. A receiver is merely a ministerial officer of the court, or, as he is sometimes called, the 'hand of the court'. The title to the

property does not change; and, if he is required to take property into his custody, such custody is that of the court (citing cases).

"The question now before the court was carefully considered in *Gaither v. Stockbridge,* 67 Md. 222, and it was held, as a necessary deduction from the principles which we have stated, that a receiver, by taking possession of a leasehold estate, did not become the assignee of the term. This case was cited with approval by Chief Justice Fuller in the case of *Quincy, M. & P. R. Co. v. Humphreys,* 145 U. S. 82, 97, 98; 36 L. Ed. 632, 637."

It is to be noted that in the *Bell* case the receiver had gone into possession, but he did not adopt the lease, and the case is authority for the proposition that he did not become an assignee of the term merely by *such taking of possession.*

In *Underhill v. Rutland, R. Co.,* 98 Atl. 1017, plaintiff sued as receiver of a foreign corporation. The state statute required a foreign corporation to file a certificate and pay an annual license tax, and in default of meeting such requirements, neither it "nor its assignee" could sue upon contracts made by it. The defendant contended that the corporation could not sue because it had failed to meet these requirements, and that the receiver was not an assignee of the corporation. The Court said:

"So the question of permitting the amendment (to the writ) cannot be disposed of without considering the source of the receiver's right to the assets of the corporation, and the relationship he sustained to the suit if the writ is amended as proposed.

"We think the receiver is not an assignee of the corporation, nor a person claiming under it, in the ordinary sense of the terms, or within the meaning of the statute, and so not within the prohibition. The receiver derives his authority and possessory rights in the property from the court appointing him, and not from any act of the corporation. *Murtey v. Allen,* 71 Vt. 377, 45 Atl. 752, 76 Am. St. Rep. 779. His possession of the property is the possession of the court by him as its officer. *Thompson v. Phoenix Ins. Co.,* 136 U. S. 287, 10 Sup. Ct. 1019, 34 L. Ed. 408. *The ordinary chancery receiver is not an assignee, but a ministerial officer appointed by the court to take possession of and preserve the property or funds in liquidation."*

The Court said, in connection with this question in *Gaither v. Stockbridge,* 67 Md. 222, (after setting forth the nature of the office and duties of a receiver and his relationship to the court):

"It is manifest that the scope of his duties and powers are very much more restricted than those of an assignee in bankruptcy or insolvency. In the case of an assignee in bankruptcy, the law casts upon such assignee the legal title to the unexpired term of a lease, and he thus becomes assignee of the term by operation of law, unless, from prudential considerations, he elects to reject the term as being without benefit to the creditors. But not so in the case of a receiver, unless it be, as in New York and some of the other states, where, by statute, a certain class of receivers are invested with the insolvent's estate, and with powers very similar to those vested in an assignee in bankruptcy. * * * *But he (the receiver) does not by taking such possession, become*

assignee of the term in any proper sense of the word. He holds that, as he would any other personal property involved for and as the hand of the court, and not as assignee of the term."

It was held in *N. Y. T. & Or. Co. v. N. Y.*, 58 Fed. 268, that a receiver is not an assignee.

Clark on Receivers, p. 459, Sec. 341, says:

> "The analogy between the title of an assignee and a receiver to property is not complete. It is not open to debate that title to the debtor's property does not vest in the receiver. * * *"

There is no question in the case at bar that the receiver did not take title to the property upon his appointment. (Rev. Code Ariz. 1928, Secs. 3881 to 3884, inclusive.)

The case of *Dietrick v. O'Brien*, 122 Md. 482, 89 Atl. 717, is direct authority for the proposition that a receiver who has adopted a lease is not an assignee of the term.

In that case the receiver had adopted a lease, was in possession for the full period thereof, and held over. The landlord contended that there was a holding over from year to year, and not from month to month (which, if true, would make the receiver liable for rent on a yearly basis rather than on a monthly basis) and the Court pointed out that the only theory upon which such a contention might be sustained would be that the receiver was an assignee of the term. It was squarely held in that case that a receiver who has adopted a lease is not an assignee for the term.

It is thus seen that a chancery receiver does not become an assignee of the term by reason of his taking possession nor does he do so by reason of his having adopted the lease.

Therefore, the position taken by counsel for appellant is seen to be based upon a proposition which is not supported by law.

The statement is further quite often made to the effect that the receiver upon the adoption of a lease becomes liable upon the covenants to pay the rent, privity of estate being thereby created between himself and the lessor. Counsel for appellant cites the case of *U. S. Trust Company v. Wabash Ry. Co.,* 150 U. S. 287, 14 Sup. Ct. 86, 37 L. Ed. 1058, (Brief of Appellant p. 8) in support of his proposition No. I.

The statement relied on is as follows:

> "If he elects to adopt a lease the receiver becomes vested with the title to the leasehold interest and a privity of estate is thereby created between the lessor and the receiver, by which the latter becomes liable upon the covenants to pay rent."

Attention is called to the language of the Court in the case of *Stokes v. Hoffman House,* 167 N. Y. 554, 60 N. E. 657, 53 L. R. A. 870, as follows:

> "Much stress is also laid upon the case of *U. S. v. Wabash etc.,* 150 U. S. 287, 37 L. Ed. 1085, 14 Sup. Ct. Rep. 86. It is there stated: 'If he elects to adopt a lease the receiver becomes vested with the title to the leasehold interest and a privity of estate is thereby created between the lessor and the receiver, by which the latter becomes liable upon

the covenants to pay rent." This statement was made on an application in the foreclosure suit in which the receiver was appointed. It may well be, therefore, that the Court intended to assert only what would constitute an equitable claim of the lessor upon the funds in court. As a matter of fact, the lessors were not allowed the rental of the whole period during which the receiver was in possession of the leased railroad, but only for rent accruing subsequent to an order made by the court on an application by the lessors, that the receiver either pay rent or surrender the road. If the right of the lessor to rent depends upon privity of estate between the receiver and the lessor, it is not entirely clear how this result was reached. That the case was really disposed of on equitable consideration appears from the conclusions of the opinion: * * *"

It is thus seen that the foregoing quotation from the *United States Trust Company v. Wabash, etc. case, supra*, is not determinative of the question of the legal relationship which arises between the lessor and the receiver upon adoption of the lease of his insolvent. See, also, "Adoption and Rejection of Contracts and Leases by Receivers", *supra*, in which article and the cases there cited, it is pointed out that the statements that "the receiver becomes vested with the title to the leasehold estate and a privity of estate is thereby created, by which he becomes liable on the covenants to pay rent" are dicta, and as a premise in reasoning, their value is doubtful.

Counsel for appellant cites Tiffany on Landlord and Tenant, Vol. 1 (Brief of Appellant, pp. 6-7) in support of his proposition No. I. A careful reading of the

quoted section and examination of all of the cases cited by Tiffany in support of his statement convinces us that it does not support the proposition (Appellant's Brief p. 5) contended for. Tiffany states in part:

> "The courts have more usually regarded the receiver as liable on such covenants, as being an assignee by operation of law, provided he has indicated an intention to accept the leasehold as a part of the assets of the insolvent tenant, but not otherwise, thus applying the same rule as is applied in the case of a trustee in bankruptcy and, by the American decisions, of an assignee for creditors."

It is to be noted that three of the five cases cited by Tiffany (Appellant's Brief, p. 7) are cases arising in New York where, as pointed out by the Court in *Bell v. American Protective League,* 163 Mass. 558, 40 N. E. 857, 47 Am. St. Rep. 481, 28 L. R. A. 452: "There are many cases in New York in which it is asserted that there is no difference between an assignee and a receiver who takes possession of leasehold premises. We understand, however, that in New York a receiver of an insolvent corporation has vested in him by statute the title to the insolvent. (Citing cases.)"

It is respectfully called to the attention of the Court that the receiver in the case of *Link Belt Machine Co. v. Hughes,* 174 Ill. 155, 55 N. E. 179, cited by Tiffany in support of the proposition, was held liable on the covenants contained in the lease, but he was held liable *because of the act of adoption,* and the question as to whether or not he became thereby assignee by operation of law was not discussed.

It is respectfully submitted for the consideration of the Court that in the case of [illegible] v. *Royal Trust Co.*, 173 Ill. 413, 50 N. E. 1049, also cited by Tiffany in support of that proposition of law, there is no discussion of whether or not the receiver is an *assignee by operation of law*, but, on the contrary, the Court places the liability of the receiver squarely upon the fact that he exercised his election and *adopted* the lease.

That Tiffany in his work on Landlord and Tenant (p. 984), did not have in mind such a construction upon the phrase "being an assignee by operation of law", as is contended for by counsel for appellant in the instant case, is apparent when read in connection with the balance of the language of that sentence as follows: "provided he has indicated an intention to accept the leasehold as a part of the assets of the insolvent tenant, but not otherwise." This language implies *adoption* by the receiver. That the receiver's liability "on such covenants, as being an assignee by operation of law"—using the term "assignee by operation of law" in its technical sense—is not equivalent to the liability of the receiver upon the adoption by him of a lease, will be hereinafter discussed.

Counsel for appellant quotes further from Tiffany (Appellant's Brief, p. 7), beginning with the language "The cases are generally to the effect," etc., to the end of the quotation on the same page of his brief.

This language is entirely inapplicable to the situation presented here, for the question is not whether the receiver accepted the leasehold. It was stipulated to by respective counsel that the lease was affirmed. [T. R. p. 24.] Therefore, since the fact of adoption is not dis-

puted, the balance of the language quoted by counsel for appellant does not help him in sustaining his position.

Furthermore, it having been shown that the term "assignee by operation of law" has been loosely used in the decisions, that there is no *decision* sustaining counsel's contention that a receiver is an assignee, and that, on the contrary, it has been squarely held that a receiver who has adopted a lease is *not* an assignee by operation of law (*Dietrick v. O'Brien, supra*), the balance of the quotation from Tiffany on Landlord and Tenant, Vol. 1, p. 987 (Appellant's Brief, p. 7), is entirely inapplicable, as well as the reasoning of counsel (Appellant's Brief, pp. 8, 9 and 10).

(b) A Receiver Is Substituted, in Effect, for the Original Lessee Upon His Adoption or Affirmance of a Lease Contract.

(1) *This is Apparent From the Language of the Decisions.*

In *Gilbertson v. Northern Trust Company* (N. D.), 207 N. W. 42, 42 A. L. R. 1353, the court said:

> "A receiver takes the estate of an insolvent for the benefit of creditors; he is in effect an assignee and *stands in the shoes of the insolvent with exactly the same rights and obligations that the latter had at the moment of insolvency.* Therefore, choses in action pass to him subject to any right of setoff existing at the time of the appointment."

Again, in *O'Dell v. Bedford,* 224 Fed. 996, the Court recognized the above principle in the following language:

> "It may be assumed that under the decisions of *Eamps v. Claflin Co.,* 220 Fed. 190, and *Atchison,*

Topeka & Santa Fe Ry. Co. v. Huntley, 153 Fed. 803, an election for continuance of a contract would have been subject to its burdens as well as its benefits and the receiver would have stood in the shoes of the Bedford Company, and therefore have been liable to pay up the arrears if they sought to reap the benefits."

The Court said in *Rosson Co. v. Pacific Radio Pub. Co.* (Cal. 1932), 11 Pac. (2d) 873:

> "* * * When he (the receiver) elected to proceed with the work, he did so just as Krieft (the insolvent) would have done, subject to the rights of plaintiff under Krieft's assignment and subject to defendant's right of setoff by virtue of his acceptance of the assignment. * * * *After adopting the contract, the receiver stood in the shoes of Krieft*; and defendant could no more relieve itself of its positive obligation to plaintiff by settlement of its account with the receiver than by a settlement with Krieft himself in derogation of the accepted assignment. (Citing cases.)"

(2) That the Receiver Is Substituted, in Effect, Is Apparent From the Fact That the Decisions Have Held a Receiver Liable for Breaches Occurring Under the Lease PRIOR *to His Adoption Thereof.*

The only theory upon which the Court can possibly come to the conclusion that a receiver, upon adoption, becomes liable for the breach of a covenant upon a lease *occurring prior to the act of adoption* is that he, the receiver, was substituted in effect for the original lessee; for otherwise, the lessor would still have a right of action against the original lessee for such breach, and not against the receiver.

In *Andrews v. Beigel,* 6 Ohio App. 427 (1915), a receiver was appointed to take charge of a brewing establishment, and in the course of operating such business he caused receiver's certificate to be issued. The lessors of the property upon which the establishment was conducted petitioned the Court that unpaid rentals, accruing before the adoption of the lease be declared prior to said receiver's certificate. The Court said:

> "Where, before the appointment of a receiver, property has been held under a lease, and the receiver takes possession, he will be given a reasonable time to determine whether he will accept under the lease or not. If he does so accept, he will be bound by the terms of the lease. * * * A careful consideration of the record convinces the court that it must be held that the receiver took under the terms of the said lease, and that under the order of the court as made on December 24th, 1910, and December 18, 1911, *both the accrued rentals prior to the receivership* and those unpaid accruing since the appointment of the receiver, are obligations of the receiver."

In *Westinghouse Elec. & Mfg. Co. v. Brooklyn Rapid Transit Co.,* 6 Fed. (2d) 547 (1925), the Court said:

> "If the receiver is not *virtute officii,* the assignee of the term, if he remains a stranger to the lease until he adopts it, he must, upon definitive action of adoption or rejection, *be held to have occupied from the beginning the same position that he ultimately assumed.* If he rejects, he must act from the beginning as one who rejects, and if he assumes, he must from the beginning, conform to the terms of the contract he has assumed."

In *Neate v. Pink,* 3 Mac. & G. 476, 21 L. J. Ch. N. S. 574, 16 Jur. 69, 42 Eng. Rep. 345, the receivers had adopted a lease upon a plantation which was held by several persons. The receiver was appointed over one moiety (*Estate of Hiatt*). In that case the estate of the insolvent was held liable for rent amounting to 2800 pounds with interest at 6%, found due by the Master appointed, which sum included a number of years' rent owing under the lease at the time the receiver took possession and adopted the lease.

The same result was reached in the case of *Johnston v. California-Washington Timber Co.,* 296 Pac. 159. There a logging company became insolvent and a receiver was appointed to take charge of the affairs of the business. The receiver adopted the contract between the logging company and the timber company and continued performance thereof. Appellant contended that the receiver had no right to pay any claims that arose under the contract prior to its adoption. The Court said, in this connection:

> "* * * But, when a receiver becomes possessed of premises belonging to an insolvent lessee or tenant, if he adopts the contract, or ratifies it, he becomes liable according to the terms of the contract. That is the effect of one of the cases cited by appellant, *DeWolf v. Royal Trust Company,* 173 Ill. 435, 50 N. E. 1049-1050 (citing from the DeWolf case, hereinafter quoted from, to the effect that 'neither courts nor receivers have any right to destroy contracts or violate obligations'). There is nothing to the contrary in the cases cited by appellant. *Central Trust Co. v. Continental Trust Company of City of New York,* 86 Fed. 517; *Dayton Hydraulic Co. v. Felsenthal,* 116 Fed. 961; *Barber Asphalt Co. v. 42nd*

Street etc. Railway Co., 175 Fed. 154; *Mathews v. Butte Machinery Co.,* 286 Fed. 801; *Spencer v. World's Columbian Exposition,* 163 Ill. 117, 45 N. E. 250. * * * The logging company certainly was bound under the contract to furnish the 2,000,000 feet of logs, and the timber company was entitled to the $3.00 a thousand for the use of any logs in the river. The receiver, having adopted the contract and assumed its performance, *was also bound by its burden to do the same thing that the logging company would be required to do.* The logs sold by the logging company prior to the receivership had not all been paid for, and the balance due was merely a balance due on the entire quantity of logs."

Was not the receiver, then, substituted for the logging company under the contract? If not, how could he, rather than the logging company, be liable for obligations under the contract which arose before the receiver adopted?

It is submitted, upon principle, that if the receiver had not been, in effect, substituted in the place of the original lessee that a right of action would have existed against the latter, but it is significant that neither in this particular case nor in any other, so far as diligent search reveals, has such a contention ever been made.

See, also:

Hanna v. Florence Iron Co., 118 N. E. 629.

The decisions of the Courts to the effect that the *appointment* of a receiver does not relieve the lessee of liability to pay rent is quite consistent with the position taken by appellee herein. (See *Bradner v. Noeson* (Cal.), 12 Pac. (2nd) 84.) A chancery receiver, as hereinbefore

pointed out, is merely a custodian of the property and does not take title by virtue of his appointment. It is only upon the election by the receiver to affirm the lease that he is substituted, in effect, for the lessee. Generally, however, where the appointmnt of a receiver is obtained at the request of the landlord the lessee is excused from the payment of rent during such dispossession on the ground that such acts on the part of the landlord constitute an eviction and is inconsistent with the landlord-tenant relationship. *Telegraph Ave. Corp. v. Raentsch* (Cal.), 269 Pac. 1109, 61 A. L. R. 366. Similarly, is not the adoption of a lease by the receiver inconsistent with the lessee's possession?

(3) *That the Receiver Is Substituted for the Lessee Is Apparent From the Fact That the Decisions Have Held That the Receiver Adopts the Lease in Toto, With All of Its Terms, Conditions and Covenants, and for the Entire Term.*

The cases are uniform in holding that upon the adoption of a lease or other contracts by a receiver, he adopts it in its entirety, and he is bound by all of its conditions, terms and covenants, and for the entire term thereof.

In *Jacob v. Roussell,* 156 La. 171, 100 So. 295 (1924), the plaintiff leased a plantation on a yearly rental basis. Thereafter the lessee went into the hands of a receiver, who adopted the lease and operated under it for a year and then surrendered. The owner sublet for a portion of the period, and seeks to recover from the receiver the difference between the amount so recovered and the rent fixed in the lease.

"Had the receiver, when appointed, elected not to assume the lease and operate the plantation, it is clear that all that would have remained to plaintiff would have been a claim for damages against the corporation, with the rank of an ordinary creditor. On the other hand, had the receiver elected to operate the plantation for the full term of the lease, plaintiff's claim for the rent for the whole of the term would have been a charge against the receiver as such. (*Spencer v. World's Columbian Exposition Co.,* 163 Ill. 117, 45 N. E. 250; *Howe, Receiver, v. Harding,* 76 Tex. 17, 13 S. W. 41, 18 Am. St. Rep. 17; *Commercial Pub. Co. v. Beckwith,* 167 N. Y. 329, 60 N. E. 642.)

The above propositions do not appear to be disputed. In fact, the receiver has acted thereon by paying in full the rent for the year during which he operated the plantation. *But the question arises whether a receiver can adopt a contract in part and repudiate it for the rest; whether he may divide a contract, taking so much thereof as he believes advantageous, and rejecting that which he deems unprofitable.*

On this point we have been furnished with no authority by either side, and we ourselves have been unable to find anything in point. But we are of opinion that the receiver cannot so divide a contract, and must take it or reject it as a whole, unless such contract be clearly separable and not entire.

And we think that a lease of lands for a term is one entire contract, even though the rent be payable in installments at intervals, and not a series of separate contracts each for a period equal to the interval between payments."

The Court stated that there was special reason why the lease there should be considered not separable, pointing out that the leased property was to be cultivated in rice and that only every three or four years a crop was profitably grown.

> "And our conclusion is that the receiver, having taken advantage of the lease for the year when a good crop could be raised, was not at liberty to surrender the land for the years when the crop might be poor. This appears to us the only *equitable* solution of the issue; and, as we find no positive law or jurisprudence in point, we must adopt it."

The *Jacob v. Roussell* case just quoted from is authority for the proposition that the receiver cannot repudiate the obligations assumed under the lease he elected to adopt and he is primarily liable thereon until the end of the term.

The receiver in the instant case would do the same thing the receiver in the *Jacob v. Roussell* case attempted to do, and that is, to accept the lease for whatever period suited his convenience and during which he might reap a benefit therefrom, and then repudiate the same and be relieved of any further liability thereon. In the instant case the receiver would adopt the lease during the period he is operating the business, and then would repudiate it when he found a purchaser for the store. The reasoning of the Court in the *Jacob v. Roussell* case is particularly applicable to the situation presented here.

In *De Wolf v. Royal Trust Company, supra,* the Trust Company was appointed receiver of the Smith Company, adopted the lease of the company and paid rent at the rate

of $75.00 a month, as specified in the lease. The receiver, under a provision in the lease, served a notice that it would surrender the premises and paid rent for the time that it was in possession. The lease specified that the rent was payable monthly in advance, which sum the lessors claimed.

> "The only question here is whether the court erred in refusing to allow the claim of $75.00, and holding the receiver not bound by the covenants of the lease. The decision, in effect, was, that the receiver could accept the leasehold interest vested in it by the order of appointment without becoming bound by the terms of the lease, and could remain in occupancy under the lease for so much of the term as it might choose, and, at its pleasure and election, abandon the premises and surrender the lease. The rule is that a receiver does not simply, by virtue of his appointment, become liable upon the covenants of a lease made prior to his appointment by the party for whom he is receiver, but he has a right to elect whether he will accept the lease, and make it his own, or whether he will refuse to accept it. It might be that it would be valueless for the purpose of the trust, or even a burden, and, if so, it could not be forced upon him. It is for this reason, that he has, subject to the order of the court, the right of election whether he will perform the covenants or not. For the purpose of making such election, he is entitled to a reasonable time to ascertain whether the lease would be desirable. The mere acceptance of the trust does not render a receiver liable for rent of the premises, and he cannot be held until he elects to hold possession as receiver, or does some act which is equivalent to such election. *Spencer v. World's Columbian Exposition Co.,* 163

> Ill. 117, 45 N. E. 250. If he remains in possession beyond a reasonable time to make the election, he, by implication, elects to accept the lease, *and becomes bound, as receiver, under its terms; and the remedy of the landlord for rent may be sought against the estate of which he is receiver.*"

The receiver becomes bound by the lease when he choses to continue it in effect.

In *Link Belt Machine Co. v. Hughes,* 174 Ill. 155, 55 N. E. 179, the owner of premises leased to a corporation, with a lien expressly provided for in the lease upon all property of the lessee, and the corporation was subsequently placed in the hands of a receiver. The lessee was not delinquent in his rental payments when the receiver took possession, and the receiver paid the first month's rent in the amount specified in the lease. The lessor thereafter claimed a preference on the funds in the hands of the receiver for rent subsequently becoming due. The Court found as a fact that there had been an adoption of the lease. With respect to the effect of adoption the Court said:

> "The parties have a right to enter into a contract of this nature, and it was binding upon the lessor and lessee. When the receiver took possession under the order of the Court the lease was not changed. The Court having ordered the receiver to occupy the leased premises under the lease the receiver took the property subject to the same terms and conditions as it was held by his insolvent. If Appellee had a lien against the property for rent he also had a lien against the property after it thus passed into the hands of the receiver."

See also *Fatheringham v. Spokane Savings Bank* (Wash. 1933), 27 Pac. (2nd) 139; *Greenstan & Greenberger v. Doerke Company,* 168 Atl. 396, affirmed 164 Atl. 471.

The rule is stated in 53 *Corpus Juris* at page 151, as follows:

> "When a contract is adopted and assumed by a receiver it becomes a contract and obligatory upon him as an officer of the court, payments becoming due thereunder being properly treated as part of the expenses of the receivership, and it must be carried out in all respects, with its burdens as well as it benefits; (citing cases) * * *
>
> "In accordance with the rules applicable to obligatory contracts generally, a receiver cannot abrogate or affect the rights of the parties under an unexpired lease made to the insolvent prior to the appointment of the receiver; but he has the option, under the supervision of the court, to adopt and assume the lease, or not to do so, and he is not bound by the covenants of the lease unless he elects to adopt and affirm it (citing cases) since he is not vested with title to the property of the insolvent and so cannot be regarded as an assignee of the term by operation of law (citing cases)."

High, Receivers, (4th Ed.) sec. 283a:

> "Upon the other hand, while the mere acceptance of the trust will not render the receiver liable, yet where, by his unequivocal acts, he has indicated an intention to receive and accept the benefits of the contract of his principal, he will be held to have elected to be bound thereby and accordingly he becomes subject to the liabilities thereby created.

(*Spencer v. World's Columbian Exposition*, 163 Ill. 117, 45 N. E. 250), and where a receiver has taken possession of the demised premises under a lease of his principal and has remained in possession after the lapse of a reasonable time in which to make his election he will be held, by implication, to have accepted the lease and to be bound thereby; *and having thus become bound by the covenants of the lease he is held to have adopted it as a whole, and he cannot afterward escape liability as to the unexpired portion of the term by serving notice upon the lessor and surrendering the possession.* (*DeWolf v. Royal Trust Company*, 173 Ill. 435, 50 N. E. 1049), *and in such case where the lease provides that the lessor shall have a lien for rent upon the property of the lessee and the receiver has taken possession and adopted the lease, he is bound by the provision, and the lessor is threfore entitled to a lien upon the proceeds of the sale of the insolvent's assets for the payment of all rent due under the lease.* (*Link Belt Machine Co. v. Hughes,* 174 Ill. 155, 55 N. E. 179.) But where a receiver has surrendered the demised premises upon the expiration of the receivership, he cannot be held personally liable under the lease for rent accruing thereafter since no privity exists between him and the lessor which could render him personally liable. (*Johnson v. Robuck,* 114 Ia. 530, 87 N. W. 491.)"

Attention is called to the fact that in *Johnson v. Robuck,* cited by *High, supra,* there was no adoption of the lease.

It was held, in *Spencer v. World's Columbian Exposition,* 163 Ill. 117, 45 N. E. 250, that the receiver could not, where he had taken possession of the premises and conducted the business which the insolvent had been un-

able to continue, and, without any act of disaffirmance or notice that he would not be bound by the contract, complete the term and receive profits, and all the benefits from such possession and continuance of the business, (being an adoption implied from his conduct) then repudiate the contract and pay only on the basis of a *quantum meruit.*

Again, in *Dietrick v. O'Brien, supra,* the receiver having adopted the lease was in possession for the term and held over after its termination. The question was as to the nature of the holding over after the leasehold term expired. The Court used the following language in considering the effect of adoption:

> "It is then, by the best-considered cases, established that if a receiver adopts the lease, he is held bound to the payment of the rent as stipulated by the lease, * * * It must not be lost sight of that a receiver is merely an arm of the court assisting in winding up the affairs of the insolvent and protecting the interests of the creditors. *If he sees fit to adopt the lease, he does so for the fixed and definite period. * * * We are of the opinion that when he adopts the lease, then he is liable on all the covenants up and until the end of the term,* but that thereafter, without any further agreement or action upon the part of either the lessor or receiver, all the law would imply would be a tenancy at will."

(4) *That the Receiver Is Substituted, in Effect, for the Lessee Upon His Adopting the Lease Is Apparent From the Application of Equitable Principles and Considerations.*

The parties herein are before a court of equity in an equitable proceeding, and equitable principles govern here. It is provided that

> "In all matters relating to the appointment of receivers, to their powers, duties and liabilities, and to the power of the court, the principles of equity shall govern, whenever applicable." (Sec. 3884, Ariz. Rev. St. (1928).

That the receiver at all times was in an advantageous position, and the lessor was at a disadvantage, is apparent upon consideration of the situation in receivership proceedings generally, and as it existed in the instant case in particular.

The receiver, upon his appointment, has the election of affirming or disaffirming leases and contracts of the insolvent. Here, he had a period of three months [T. R. p. 24] within which to determine what contracts and leases he desired to adopt. The receiver is generally given a reasonable period within which to determine whether or not he will consider the executory contracts of the insolvent to be of benefit to the receivership, and if he does elect to adopt, the lessor has no choice, but must perform. He has no alternative.

If the receiver had rejected the lease in the instant case, the lessor would have had several remedies which he could have pursued at that time. He would have had a right to assert his statutory landlord's lien upon all of

the lessee's merchandise, fixtures, furniture and all other personal property upon said premises to secure the payment of the rent for the full term of said leases, as well as to secure the performance of all of the terms of said leases. [T. R. pp. 17-18.] His lien, if asserted at that time, would have been a preference over all other claimants, and its value would be measured by the value of the property upon the demised premises.

In *Fec-Crayton Hardwood Co. v. Richardson-Warren Co.,* 18 F. (2d) 617, the owner of premises executed a lease thereof to a mill and lumber company which subsequently was placed under receivership. A statutory landlord's lien was in effect in Louisiana, giving the lessor a lien and pledge upon all of the property situated upon the property at the time of the execution thereof or that was subsequently placed upon the premises, for the payment of the rent, whether due or to become due. The landlord intervened, claiming a preference against the fund in the hands of the receiver over all other claims presented. The Court held that his claim was a first lien upon the funds, prior to all other claimants.

In *Link Belt Machine Co. v. Hughes,* 174 Ill. 155, 55 N. E. 179, appellee, owner of premises, leased to a corporation, with a lien expressly reserved upon all the property of the tenant. The corporation was subsequently placed in the hands of a receiver. The Court held that the lessor was entitled to a preference over the demands of all other claimants, and costs of administration.

The nature and extent of the statutory landlord's lien given in Arizona (Ariz. par. 3671 Rev. St., 1913; Ariz., par. 1958 Rev. Code Ariz. 1928) was considered in

Murphey v. Brown (Ariz.), 100 Pac. 801. In that case Murphey leased a portion of the building owned by him to Brown, who later became insolvent and made an assignment for the benefit of creditors to S, who sold the entire stock of goods on the premises to F, who immediately entered into possession and advertised that he would sell the stock at public auction, at *greatly reduced prices.* Murphey claimed his lien. The Court, in discussing the rights of Murphey under this lien law, stated:

> "To restate the question: Is the landlord under this statute protected for the payment of his rent from the moment his tenant's chattels are placed upon the leased premises, or does his protection begin only after the obligation for rent has matured? If the latter, then the landlord is but little aided by the statute; for he may obtain a lien by attachment for rent due. If the former, his protection is as complete as the value of the property upon the demised premises may make it. * * * *The conclusion seems inevitable that the lien attaches for the entire term of the lease on all property of the tenant, placed upon or used on the leased premises, and subsists until all rent for the term has been paid.* The Supreme Courts of Iowa, Alabama, and Arkansas have reached the same conclusions upon similar statutes (citing cases)."

In the event, then, that the receiver had rejected the lease in question, the lessor would have been protected to the extent of the value of the property on the premises *at that time.*

The lessor would have also had, in that event, the right to recover damages against the estate of the insolvent lessee for breach of contract, and may have other remedies against the lessee. (Clark on Receivers, p. 604, Sec. 446.)

However, by reason of the act of adoption by the receiver, the lessor was precluded from pursuing these remedies. He could only wait until the receiver decided whether he would adopt or not, and upon his doing so [T. R. p. 24], the lessor had to continue performance.

Furthermore, the lessor's right to assert his lien against the property was held in abeyance during the entire time that the receiver was in possession of the premises because the receiver was not delinquent in the payment of rent. The lessor could not, therefore, assert his lien against the property prior to the time the receiver delivered possession to the purchaser. He did give constructive notice by filing his claim for rent [T. R. p. 13] that he asserted his lien, which was all he could do under the circumstances. He did this on May 2nd, 1932. [T. R. p. 13.]

The receiver was not only in an advantageous position at the time he was appointed, but continued so during the period of his occupancy.

The lessor was forced to enter into the landlord-tenant relationship with the receiver upon the latter's election to affirm the lease. It is a general principle of law that a party to a contract has the privilege of choosing the other party to the contract, but such is not the case where the receiver adopts an existing contract. The lessor entered into the lease with the lessee voluntarily. He does not do so when a receiver takes over an existing lease. His protection, however, lies in the receiver's bond, his official position as an officer of the court, his neutral attitude toward all claimants, and the fact that he owes an equal duty to all claimants to administer the affairs of the insolvent, to preserve the assets, and to make distribution of the funds according to the rights established by the

parties asserting rights thereto. A receiver represents no particular interest or class of interests. He holds for the benefit of all who will ultimately show an interest in the property. He stands no more for the creditor than the owner. (*New York, etc., Co. v. New York, etc., Co.*, 58 Fed. 268); *High on Receivers* (4th Ed.), p. 161, Sec. 138. High states the duty of the receiver to preserve existing liens as follows:

> "And where property comes into the possession of a receiver subject to pre-existing liens, it is as much his duty to preserve and protect such liens in favor of the holders thereof as to make a just distribution of the assets among the unsecured creditors (citing cases)."

See, also:

Beach on Receivers, p. 318;

Clark (2d Ed.), p. 469, Sec. 354.

Furthermore, at the time the leasehold interest was transferred [T. R. p. 34], the receiver had the power to protect himself and the interests of all the claimants to the funds, while the lessor could only stand by. He could do nothing to protect himself, but had to look to the receiver to preserve his rights. The receiver could, and should, have taken security for the faithful performance of the terms and conditions of the leasehold transferred to Schwartz, the purchaser. Such provisions are proper (*Guaranty Trust Co. v. Metropolitan Street Ry.*, 177 Fed. 925 (C. C. A. 2nd, 1910)), and customary. (See decrees cited in note 112, "Adoption and Rejection of Contracts and Leases by Receivers," *supra.*) The lessor has lost the right to assert his statutory lien against the prop-

erty itself by reason of the irresponsibility of the purchaser of the property upon the leasehold premises. The receiver could have prevented the loss to the lessor, and yet have protected the fund of the insolvent against loss to the other claimants by requiring such security from the purchaser, but he failed to do so. His failure was a breach of duty he owed to the landlord.

It is argued, however, by counsel for appellant [T. R. p. 11], that "the landlord was (by the sale) placed in no worse situation than he was in when the receiver took possession," and, further, that "there is no showing of inequitable conduct on the part of the receiver." On the contrary, we submit that the receiver was guilty of conduct here which resulted in grave injustice being done to the landlord, while the latter is entirely free from blame, and did whatever was in his power to do to preserve his lien and to assert his rights. That he was diligent in all matters was expressly found by the court. [T. R. p. 36.] The receiver not only failed to take security for the performance of the lease, but *he placed the purchaser in possession of the premises* on November 16, 1932 [T. R. p. 20], while he did not file the petition and obtain the order for the sale of the property until November 23d [T. R. p. 19], and the owner of the premises was not notified of the sale nor the change of possession until November 30, said notice being received on that date by the attorney for the appellee herein, at Los Angeles, California, a distance of 250 miles away; yet appellee's attorney-in-fact, with whom business transactions involv-

ing this property had previously been had, was living in Yuma. [T. R. p. 20.] It is stipulated in the record that the receiver had theretofore discussed matters touching appellee's interests with him, but that the change of possession and sale was made without notice of any kind. [T. R. pp. 20-21.] What protection did the landlord have during this time? It was the following Saturday night and Sunday, the 3rd and 4th days of December, that the purchaser, Schwartz, moved out all the merchandise and much of the movable fixtures used in connection with the grocery business conducted on the premises. [T. R. p. 21.]

Can it seriously be contended that there was no inequitable conduct on the part of the receiver calling for the application of equitable principles?

It is unthinkable in a court of equity that the receiver should not be held responsible as a substituted party on the lease. He entered into it voluntarily. He would be liable on contracts he, himself, as a receiver, made and entered into. *Clark on Receivers,* p. 589, Sec. 428, states that "If the receiver does adopt a contract it is a voluntary act of his own, to be performed with promptness." He says, in the same work, at page 602, section 443, that a receiver becomes liable upon the covenants because and only because of his acts in respect thereto.

In conclusion, we submit that, while the act of adoption of an existing lease does not constitute true novation because one of the essential elements of a new contract—

that of assent—is quite often absent, yet, in effect, there is a substitution of the receiver for the original lessee.

The language of the courts to the effect that the receiver "steps into the shoes" of the insolvent, the decisions that he is liable for defaults occurring *prior* to his adoption, and that he is liable thereon for the whole term, sustain the proposition of law advanced by counsel for appellee here that the receiver is, in effect, substituted for the original lessee. The proposition advanced here is consistent with the decisions of the courts that where there is no adoption of the lease by the receiver that the lessee remains liable for the payment of rent, for in such case the receiver is merely the custodian of the property and the legal relationship between the lessor and lessee is not disturbed. It is consistent, too, with the decisions of the courts that a lessee is excused from the payment of rent if the appointment of the receiver is obtained at the request of the landlord, upon the ground that such act by him constitutes an eviction and is inconsistent with the landlord-tenant relationship. Similarly, is not the adoption of a lease by the receiver inconsistent with the lessee's possession and continuing liability under the lease? Furthermore, in the instant case, it is consistent with the conduct of the receiver, in that he did not require the purchaser, Schwartz, to assume and discharge the contracts, leases, and agreements made by him or adopted by him. He, himself, was, and is, primarily liable thereon, and continues to be so liable until the end of the term.

II.

One Having a Landlord's Lien Upon the Personal Property of the Lessee Upon the Demised Premises, Is Entitled to Assert His Lien Against the Funds of His Insolvent Lessee in Custodia Legis.

(a) He Has a Statutory Right.

The statutes relied on by appellee herein to give him a preference over all other claimants against the funds in the hands of the receiver are set forth in full in this record. [T. R. pp. 17-18.]

It was held in *Murphey v. Brown, supra,* that the protection to the landlord under this statute is "as complete as the value of the property upon the demised premises may make it," and, further, "subsists until all of the rent for the term has been paid." It is a preference which arises at the time the leasehold estate is created and cannot be destroyed by the act of a receiver, and, furthermore, the landlord may assert the lien against the funds of the insolvent in the hands of the receiver. (*Fee Crayton Hardwood Co. v. Richardson-Warren Co., supra; Link Belt Machine Co. v. Hughes, supra.*)

In the *Fee-Crayton* case, the facts of which have been heretofore set forth, the court said:

> "This lien is a thing distinct from the primary obligation of the lessee or assignee to pay the rent, and may be asserted against the pledged property so long as it remains upon the premises, regardless of who may be primarily responsible for the rent. The lessor timely asserted her claim after the property had been taken into the hands of the court, through its receiver, and before portions at least of the lumber and mill property were sold, and before any distribution of the proceeds had been made.

"Granting that the receivers had the right to repudiate the lease, they could not destroy the lien, and such rights as were acquired by the lessor against the purchaser at the receiver's sale I think were merely additional to those which she enjoyed against the property. If the lessee, his assigns, or the owners of the property affected by the lien, could not take it off the premises or otherwise destroy the rights of the lessor without her consent, I do not see how this could be done by the receivers. To so hold would be to say that the mere filing of a bill of complaint and taking possession of the property by the receivers could have the effect of destroying an otherwise substantial right and lien under the state law. I do not think this can be done.

"The lease itself does not provide that the failure to pay any installment shall have the effect of maturing the balance of the unpaid rent; but, if judicial proceedings had not intervened, the lessor could have exacted that the security which she enjoyed continue to remain upon the premises until the discharge of all the obligations as they matured under the contract. The liquidation by the courts of the affairs of the corporation and the converting of its assets to money has made this impossible, and I think the lessor is entitled to be paid the amount of her matured claim in full; but as to that to become due the same should be discounted at a reasonable rate, say, 6 per cent. per annum."

In the instant case, as has been heretofore pointed out, the lessor cannot assert his lien *against the property* by reason of the negligent and inequitable conduct on the part of the receiver, but the lien is not lost to him. He

may satisfy it out of the funds in the hands of the receiver.

The decision of the court in *Link Belt Machine Co. v. Hughes, supra,* seems particularly applicable to the situation presented here. In that case the rent was not in arrears when the receiver was appointed. He paid the first month's rent, under the lease, and the next two months' rent was paid by order of the court. Thereafter, upon order of the court, the property was sold for $2,218. Upon the receiver's report of the sale being made, the lessor filed a supplemental petition, claiming a lien upon the proceeds for the rent due to date, which amounted to $4,800. under the lease by that time. It was held that, inasmuch as there had been an adoption of an existing contract which reserved a lien, the landlord was entitled to a first lien upon the proceeds of the sale. The question arose as to whether the rent found due under the lease, the money borrowed by the receiver to conduct the business, receiver's fees, and other expenses, should not be pro rated. The court said, in this connection:

> "We are not called upon to determine that question in this case. The lease in question expressly gave to appellee a lien upon all the property of the receiver for rent which should remain due and unpaid. The parties had a right to enter into a contract of this nature, and it was binding upon the lessor and lessee. When the receiver took possession under the order of the court, the lease was not changed. The court having ordered the receiver to occupy the leased premises under the lease the receiver took the property subject to the same terms and conditions as it was held by his insolvent. If appellee had a lien against the property

for rent he also had a lien against the property after it thus passed into the hands of the receiver * * * and in this case, *where the property was sold by the receiver under an order of the court, preserving whatever rights existed in favor of appellee, his lien continued and was transferred to the proceeds arising from the sale of such property, and was prior to the claims of the other creditors or other costs.* In the absence of such a lien reserved upon the property in the lease for the payment of unpaid rent a different question might arise as to the pro rating of the purchase money between a landlord and those entitled to the costs of administration.

"Appellee having the right to his lien upon the purchase money arising from the sale of the property upon which he had reserved his lien for unpaid rent, and also to receive from the receiver the same rent provided for in the lease, it is unnecessary to discuss the other questions raised."

The *Link Belt* case answers the question raised here as to the landlord's right to transfer his lien to the funds in *custodia legis.* The facts are strikingly similar to the facts in the instant case, and the decision is determinative of the rights of the litigants here.

However, we will answer the contentions raised by appellant in this connection.

When the property is in *custodia legis,* the landlord may assert his lien against the fund (as opposed to the proceeds derived from the sale) in the hands of the receiver. (See note, 9 *A. L. R.* 330, at 333.) Appellant admits this. (Brief of Appellant p. 11.) He admits that if the receiver is bound for the rent of the full term of the lease that he "could, of course, discharge by apply-

ing thereto any funds in his hands belonging to the estate, including proceeds from the sale." We maintain that the lessor is entitled to assert his preference, to the full value of the property placed upon and used by the tenant upon the premises, and that he may assert his claim as a general creditor against any funds in the hands of the receiver, for any balance due him over and above the value of the preference created by the lien. He is not limited, in his preference, to the amount realized by the sale, for that sum is not the measure of the landlord's preference, but rather, it is to be measured by the value of the property upon the premises, or used thereon by the tenant. (*Murphey v. Brown, supra.*)

Counsel for appellant contends that since the sale was made "subject to the lien", appellee still has his right to proceed against the property (if he can find it), and that the lien is not transferred to the proceeds of the sale. He states the rule (at page 12 of his brief): "But if the property of the tenant is taken into the custody of the law and converted into money, the lien will attach to such proceeds." (35 C. J. 503, par. 1483.) Counsel for appellee has also examined carefully the five cases supporting the text, as well as other cases applicable to this situation, some of which will be hereinafter discussed, and he finds that in none of the cases there cited, with the exception of *Lemay v. Johnson* (1870), 35 Ark. 225, was there any mention of the question as to whether the sale was made free of or subject to encumbrances. Counsel for appellant takes the position that if the sale is not made free of the lien that it is made subject thereto, although not expressly so stated. In the *Lemay* case, a sale of perishable personal property was made by the receiver,

and the court held that the landlord was entitled to assert his lien against the funds in *custodia legis,* saying that:

> "There is no proof that it brought less than its full value, nor was there any order that it should be sold, subject to prior liens."

thus implying that if it was not sold "subject" that it was sold free of liens. Since the order here did not expressly state that it was not made free of liens, we do not concede the point that it was therefore made subject thereto.

Other cases, in addition to those cited in *Corpus Juris, supra,* bearing on this point are *Robinson v. McCay* (1829), 8 Mart. N. S. (La.) 106, wherein it was held that where the statute gives a landlord a preference for rent as against property on the demised premises or which has been removed therefrom if exercised within a specified time after removal, that such preference extends to the proceeds of a tenant's goods removed and sold by the personal representative or curator of his estate, and under similar provisions in the Porto Rico Civil Code, it has been held that the landlord's preference or lien follows the proceeds of the tenant's goods and crops in the hands of his receiver. *Welch & Co. v. Central San Cristobal* (1914), 7 Porto Rico Fed. Rep. 205. In that case the receiver had adopted a contract which reserved a lien. The Court said:

> "All valid liens created by law are recognized by the Federal courts, and, in a proper case as to citizenship, must be enforced there.
>
> "This is not only true as between persons, but in case of receivership also. It is true that the receiver has the option to adopt contracts or to repudiate onerous preexisting contracts, as has been held by

> this court in a number of instances. But where a contract has been adopted, any lien that goes with the contract or security for the contract is itself adopted. A receiver's possession is subject to all valid existing liens upon the property at the time of his appointment, and it is his duty to preserve and protect such liens. High, Receivers, pp. 159-161. To the same effect is Beach on Receivers, p. 318. The receiver is an officer of the court, and the funds or property in his hands is in *custodia legis* for the benefit of whoever may finally establish title thereto. High, Receivers, p. 3."

Furthermore, it is apparent that counsel for appellant was confused in his own mind as to the sale being free of or subject to existing liens, for he argues and quotes to the effect (pp. 14-15 of his brief) that the receiver ordinarily has no power to sell free from encumbrances, but that power may be given, and such sales made, and in that event the lien is transferred to the proceeds. But since he contends that the sale was made *subject* to existing liens, we fail to see how the quoted language as to the power of a court to sell free of liens under certain circumstances is applicable to the situation presented here.

(b) He Has an Equitable Right to Assert His Lien Against the Funds in Custodia Legis.

Counsel admits (at page 11 of his brief) that if there was any inequitable conduct on the part of the receiver, or if the appellee had lost his lien upon the property "by reason of anything the receiver had done in the premises", there might be a basis for transferring the lien to the proceeds.

It is a familiar principle of equity that the law respects form less than substance. Counsel would give appellee a mere husk—a right to assert his lien against the property—and deny him the kernel—the right to assert it against the fund—on the ground that, as he asserts, the receiver has done no wrong.

This is a situation calling for the application of the powers of equity to relieve against an injustice. The landlord was diligent in all things concerning the preservation of his lien. This was expressly found to be true by the trial court. [T. R. p. 36.] It is a familiar maxim that "Equity aids the vigilant and not those who sleep upon their rights." We have shown that the landlord stands at a disadvantage during receivership proceedings. On the other hand, as has been hereinabove pointed out, the receiver, standing in a position of advantage, and having a duty to this landlord to preserve his lien, equal with his duty to the other creditors to safeguard their rights, utterly failed to protect the landlord. It had been his custom to discuss matters involving the business he was operating upon the premises with the appellee and his agent. [T. R. p. 20.] He caused the purchaser to be placed in possession of the premises on November 16th, and did not petition the court for an order, and did not obtain the order authorizing the sale until November 23d, and did not give notice to the appellee herein until November 30th, and then gave it to appellee's attorney at Los Angeles, California. The attorney-in-fact of appellee herein, with whom he usually discussed matters and transacted business, was living at the time at Yuma, where the premises are located. [T. R. p. 20.] He owed a

duty to the landlord to preserve his lien, and we submit that he failed to discharge that duty.

The receiver stood in a position where he could, and should, have taken security for the performance of the terms and conditions of the leasehold interest transferred to Schwartz, and particularly so in this case, inasmuch as the landlord had given constructive notice by filing his claim for rent under the statutory landlord's lien law of Arizona months before. [T. R. p. 13.]

Equity says that "Where one of two innocent persons must suffer by the act of a third, he, by whose negligence it happened, must be the sufferer." Surely, this is a situation calling for the application of this rule.

Equity powers are broad and are applied to varying situations in order to relieve an innocent party from an injustice. If the legal remedy fails, equity steps in, for it is unthinkable that there should be a wrong without a remedy.

It is respectfully submitted that the decree of the lower court was correct, and should be affirmed.

Respectfully submitted,

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Attorney for Appellee.